Redefining SME banking

How banks and FinTechs can help small and medium enterprises (SMEs) across MENA build back better from the COVID-19 pandemic

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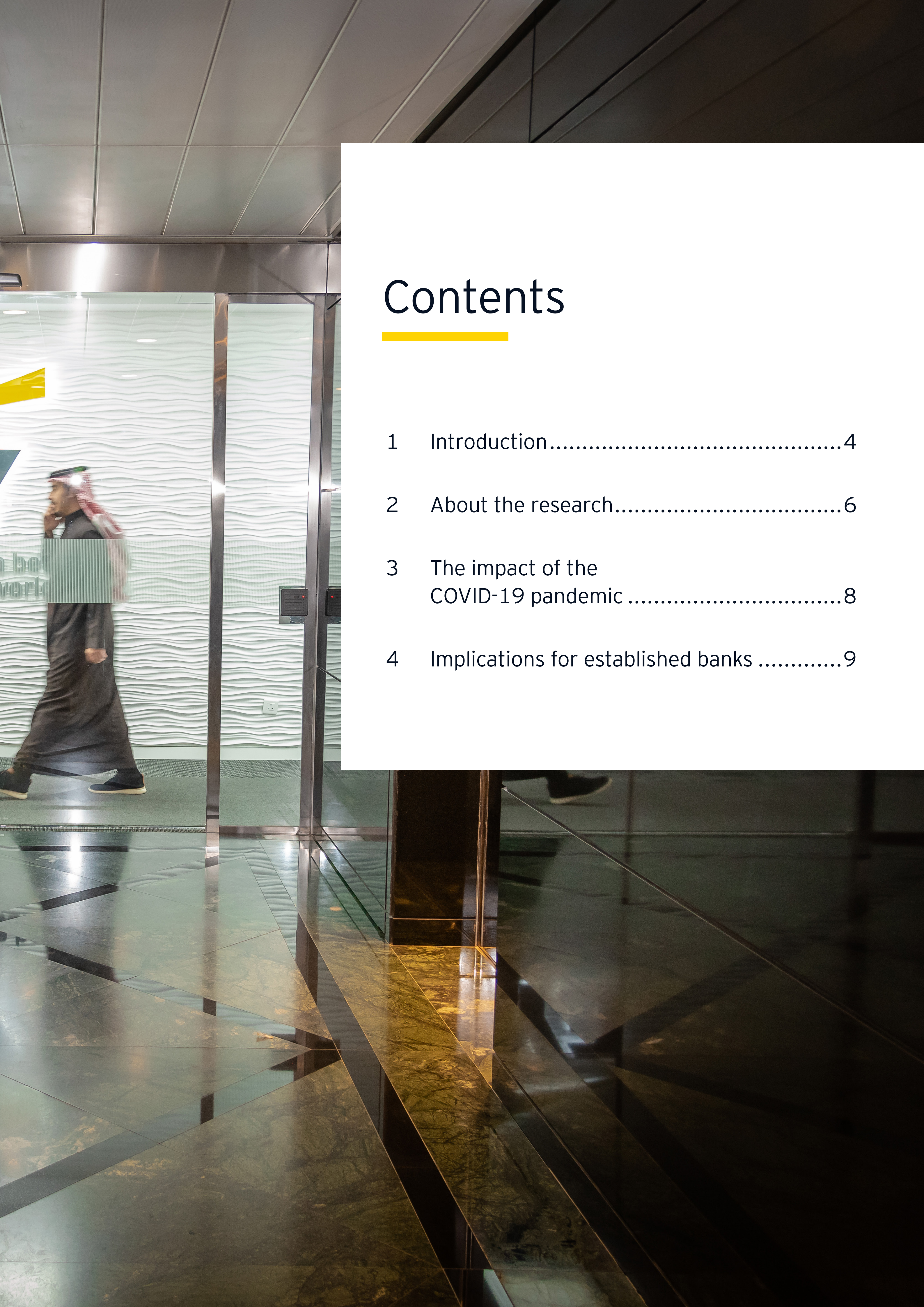

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Introduction

SMEs are the engine room of economies across Middle East. In the UAE, for instance, they constitute about 47% of GDP, and employ about 80% of the private sector workforce. Their success underpins consumer confidence and builds momentum to drive growth and economic prosperity. As the region begins to emerge from the COVID-19 pandemic, SMEs will play a pivotal role in underpinning the pace at which MENA countries, large and small, recover.

SMEs are a dynamic and rapidly evolving segment, defined by diversity. The segment is a composite of unique businesses from different sectors, operating at different stages of the business life cycle, with different ambitions, varied prospects and often with owners or leaders with markedly different personalities. It is a complex and disparate segment that is bound together by size and operational needs. SMEs across MENA represent a US$7b potential profit pool for banks, with over US$100b in financing needs, but have struggled to access financing even before the COVID-19 pandemic upended the world.

The COVID-19 pandemic has been a difficult time for many SMEs, bringing new challenges and amplifying other long-standing ones. At a time of profound change and continued uncertainty, it can be hard to chart a course for the future. Some have reveled in the COVID-19 pandemic, but they are more the exception than the norm. Most have been challenged in ways they would never have imagined.

> MENA SMEs have traditionally been underserved by established banks. They are perceived as higher risk (even though banks will often lend readily to their principals) and costly to serve. Yet, they represent a significant opportunity for digital-native challengers to serve in innovative new ways.
>
> Suruj Dutta
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> EY MENA Payments and SME Banking Leader

As banks or financial service providers transform to better meet the needs of SMEs, insight into the prevailing dynamics is imperative to understand:

- **The SME journey:** including any challenges or opportunities based on their business life stage
- **The impact of COVID-19 pandemic:** how SMEs have adapted to cope with the impacts of the COVID-19 pandemic
- **Relationships with banks or financial providers:** exploration of the status of current relationships with their bank or financial provider and usage of products and services
- **Changes to the SME business model:** the evolution and the support needed to adapt
- **Support requirements during moments that matter:** opportunities for banks to help and overcome challenges and optimize opportunities
- **Sources of finance:** factors of importance in the decision-making process

Against the backdrop, the EY organization has set in place a comprehensive program of research across 20 markets to engage with SMEs and listen to their experiences, needs, expectations and aspirations. It was underpinned by 5,698 surveys and a series of one-on-one, in-depth interviews with SMEs and with representatives from major banks. This report presents the key insights from across the MENA region.

About the research

The research program involved both qualitative and quantitative research across three stages:

1

Interactive client immersions

Discussions with major clients to capture their perspectives on the SME segment and develop insights to inform key areas of coverage with a focus on key risks and challenges. Eight immersions

2

In-depth interviews with SMEs

Exploratory deep-dive interviews with a range of SMEs from the UAE, Kingdom of Saudi Arabia and Kuwait (by size, sector and market). Key focus on unpacking the contextual dynamics that underpin the SME experience. **50+ in-depth interviews**

3

Qualitative surveys with SMEs

Online surveys with a representative sample of SMEs across key MENA markets to quantify SME experiences, perspectives, and opinions within each market. **700+ survey participants**

Definition of an SME: for the purpose of the study, an SME was defined as a business with between 10 and 249 full-time equivalent employees.

Market coverage

US
n=903

Canada
n=301

Brazil
n=126

Germany
n=300

UK
n=712

Indonesia
n=304

Italy
n=300

Netherlands
n=305

Switzerland
n=307

Belgium
n=310

Ireland
n=310

Australia
n=306

Hong Kong, China
n=306

Malaysia
n=300

Singapore
n=301

Vietnam
n=307

UAE
n=300

KSA
n=309

Kuwait
n=107

Sample of the SMEs considered for the survey across the world

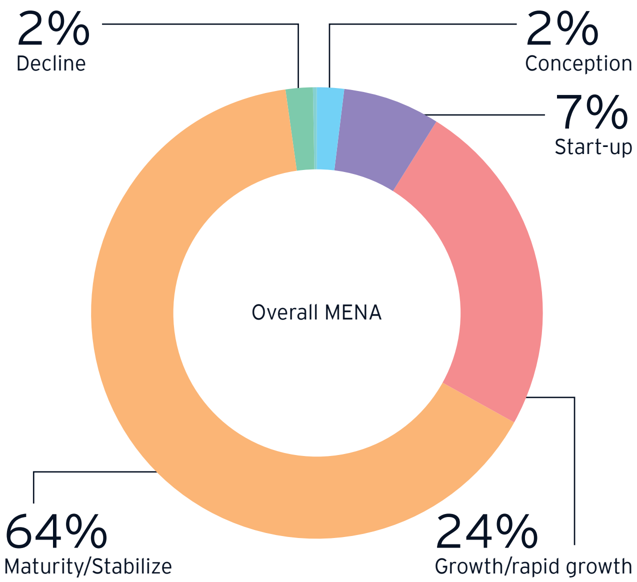
The sample size for each market needs to be considered when looking at individual market data and any subgroup analysis.

Weighting: The data has been weighted to ensure that it is reflective of the profile of the SME market within each market based on the number of employees. For the MENA-level data, each market has been given equal weighting to help ensure the results of each market are sufficiently represented in the regional results.

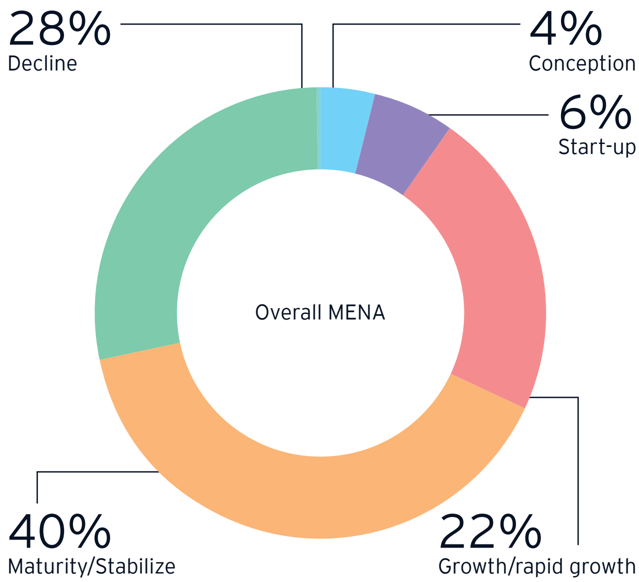
The impact of the COVID-19 pandemic

The COVID-19 pandemic has had a profoundly negative impact on SMEs in the region.

The business cycle has inverted with 83% of MENA SMEs either in decline, or with stalled growth. In the UAE, 29% of SME are in decline compared with 3% pre-pandemic times. For the KSA and Kuwait, the numbers are 24% and 39% in decline post-pandemic as compared with 3% and 0% pre-pandemic respectively.

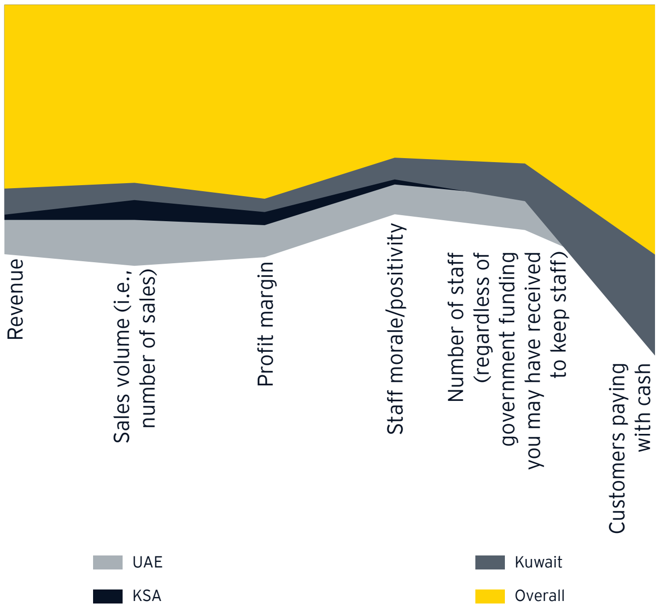


Pre-pandemic level business lifecycle

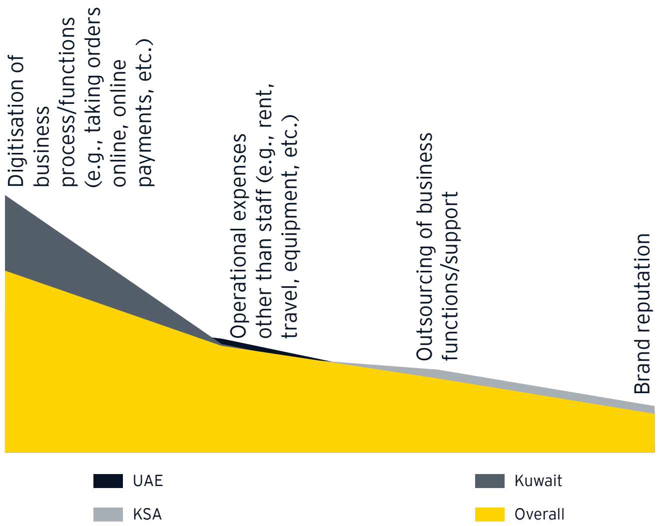


Post-pandemic level business lifecycle

The COVID-19 pandemic-induced contraction in economic activity has resulted in reduced sales, a 40% increase in operating expenses and a negative impact on gross margins for 58% of businesses.



Reduction (%) of key business metrics post-pandemic



Increasing trends observed post-pandemic

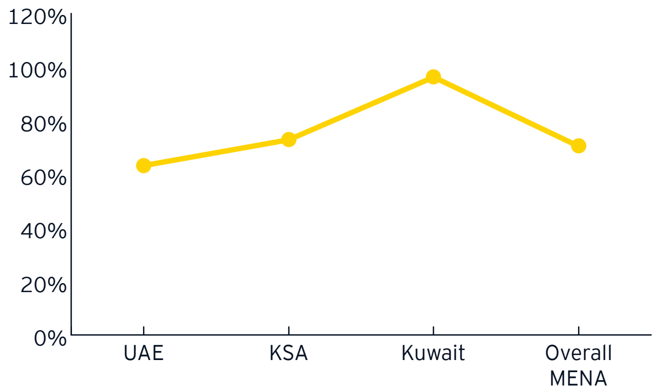
Most SMEs have borrowed heavily to stay afloat during the COVID-19 pandemic, with 51% now worried about their ability to repay their loans. SMEs in countries where government support has been through commercial banks (e.g., the UAE) are even more exposed, with 20% worried about their future solvency.

Implications for established banks

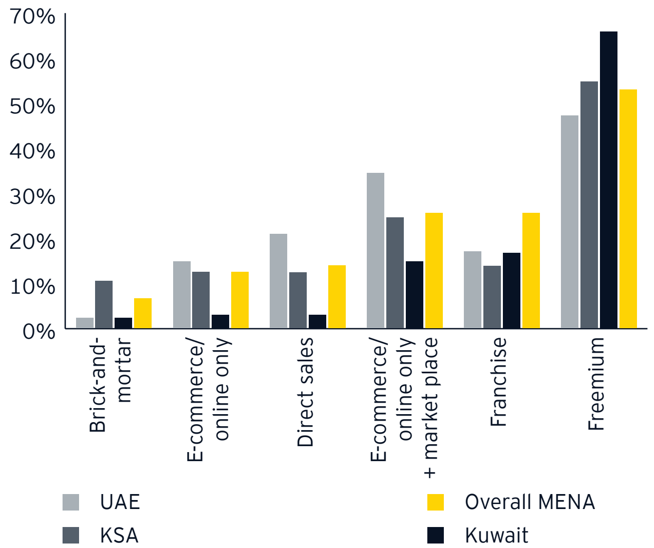
As SMEs restructure to survive, banks risk losing relationship banking privileges to nimbler digital-native emerging banks, FinTech and BigTech competitors

Approximately 60% of SMEs are changing their business and operating models to restore profitability and growth. Many have no alternative, with an up to 56% decline in businesses revenues and 73% decline in customers paying by cash.

In response, most SMEs are focused on driving operational efficiencies through digitization. Approximately 65% of SMEs surveyed are digitizing their processes and moving to mobile or online sales models. Approximately 40% of the businesses are changing gears to become freemium and mobile-commerce-led businesses.



% of SME undergoing changes in business model



Business model changes across MENA

SMEs need business advisory support to restructure operations for profitability and transition to new business models

Approximately 75% of MENA SMEs report that they expected but did not receive business advisory support from their traditional banks.

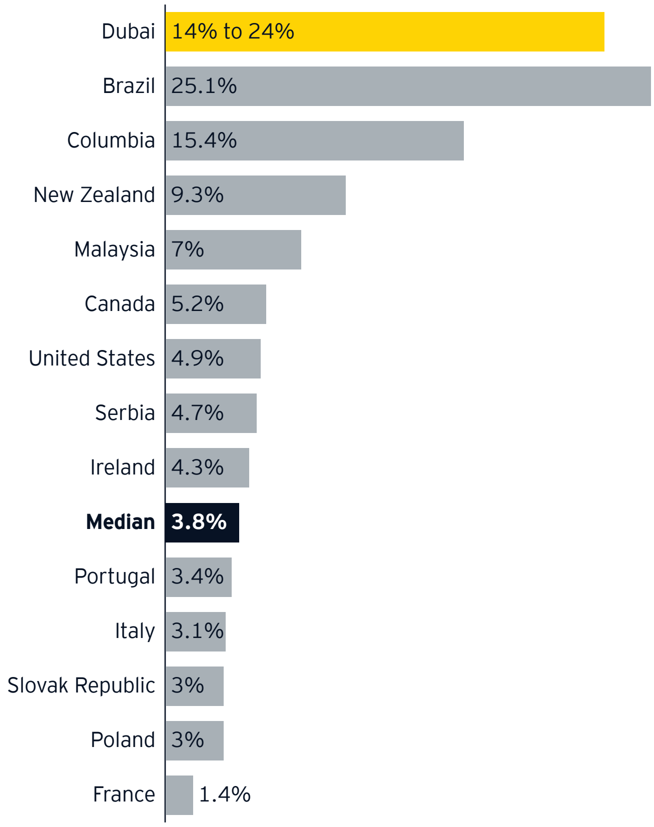
So what: SMEs are increasingly turning to specialist technology-enabled business and financial advisors to help them restructure their businesses, secure financing from a wider range of providers and access public markets for financing. Approximately 85% of the SMEs expect the Relationship Managers (RMs) to be involved in the business and develop the long-term strategy for the SME by recommending best suited product as per the life stage of the business.

Leading banks will restructure and retrain some of their RM populations on the nuances of serving SME, arm them with SME industry vertical-specific insights, and turbo-charge the new SME RM pools with data and insights on individual SME customers. They will also iteratively refine alternative pooled and video RM models to serve smaller SME more cost effectively.

Laggard banks will miss out on the deeper business and financial relationship afforded to digital-native competitors that are able to verticalize their SME RM propositions. As a result, they risk losing the deeper insights into the SME customers' businesses and risk being limited to offering financing products that are unsuitable to SME needs.

SMEs need financing support to put their businesses on a more even keel

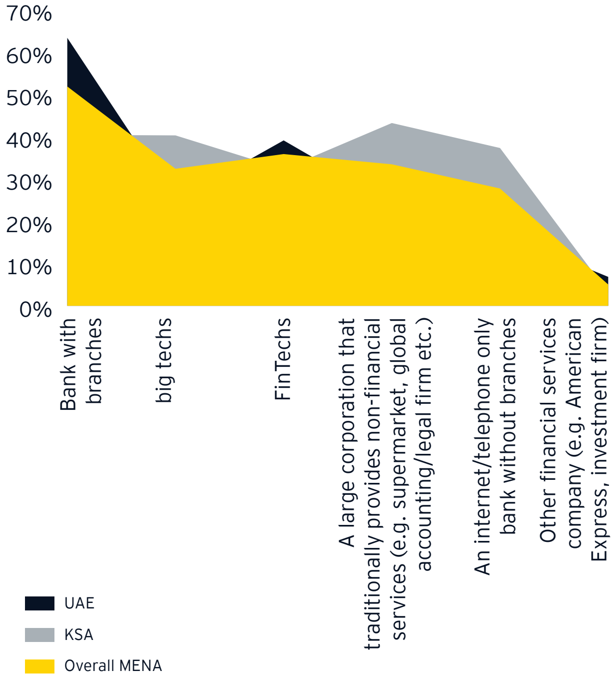
Half of SMEs cite need for additional financing to support growth or to restructure the COVID-19 pandemic loans and ~20% are looking for IPO support as they look to transition or grow. However, they struggle to access financing at reasonable rates. E.g., in the UAE, SMEs face the highest rejection rate, 52% for financing given a transient population and perceived credit risk (even though the principals for these same SME are able to secure personal loans much more easily). Even the successful SMEs face some of the highest interest rates ranging from 14%–24% for such financing, second only to Brazil.



UAE interest rate for SMEs are one of the highest amongst the world

Approximately 70% of the SMEs are looking for fresh funds to recover from the COVID-19 pandemic, ideally with funds made available within a 15-day window. This requires a significant leap in traditional bank capabilities to engage with SME digitally to understand financing needs and to rapidly assess credit risks with alternative models. It also requires reengineered business logic and process designed to compensate for 3 years-worth of audited financial statements, and front-to-back digital loan disbursement processes.

So what: About 39% of SME businesses state that they are looking to FinTech or BigTech for future financing needs. This trend is even more pronounced in the UAE, which has a thriving FinTech ecosystem, with 30% of SMEs looking to nontraditional sources of financing. Both regional and global FinTechs are also looking to serve the KSA market, with Saudi Central Bank (SAMA) granting licenses to 28 FinTechs over the past 12 months, setting up standardized data exchanges through Saudi Authority for Data and Artificial Intelligence (SDAIA) and modernizing real-time payment rails through Saudi Payments.



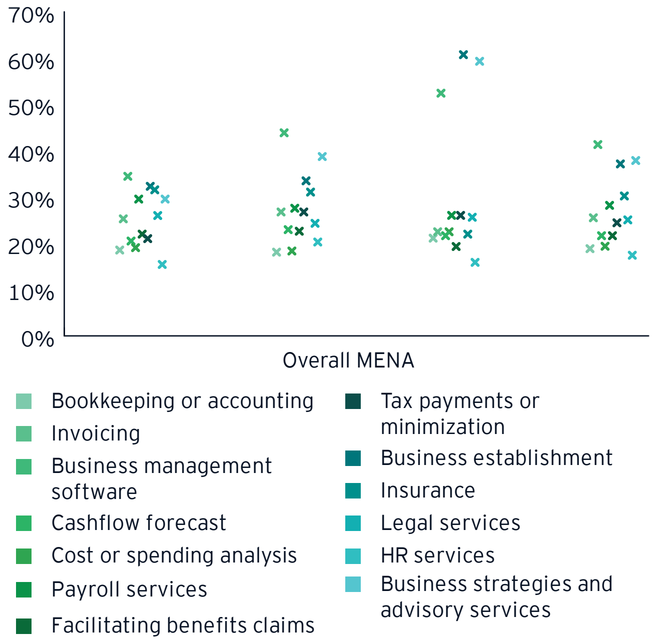
Percentage of SME businesses willing to switch finance provider

Leading banks will rapidly create nimbler new and alternative credit scoring models that are able to better predict credit risk for smaller SMEs, leveraging cloud and artificial intelligence (AI) technologies that are already mainstream across Asia. This will enable digital-first lenders to dominate the market for short-term working capital loans initially, and subsequently for more complex products as these firms amass data on SME customers business models, stock and inventory levels. This will subsequently lead to increased product penetration post onboarding.

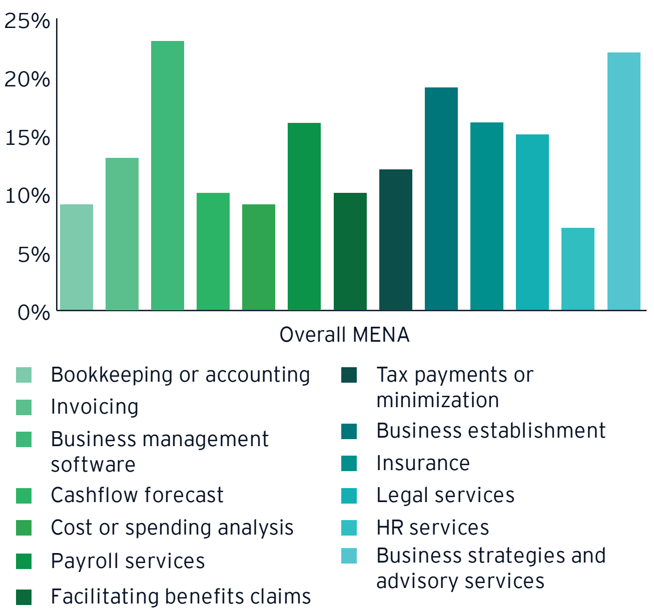
Laggard banks will continue to struggle to lend to SME customers, given that their archaic credit risk models will be better suited to serving larger, more established corporates with audited financial statements. The larger corporate and commercial customers, of course, have access to financing from a much larger set of providers, and are often able to set the terms for such lending thus increasing the skewness of the credit disbursal amongst the industry.

SMEs are digitizing rapidly, and expect their financial providers to follow

Coming out of the COVID-19 pandemic, MENA SMEs are much more digital in their banking expectations, with 65% citing mobile or online as their preferred channel for fulfilling banking needs. They are also increasingly frustrated with traditionally manual and disjointed banking processes, e.g., 46% cite frustrations with the amount of paperwork and repeated steps with the onboarding processes of traditional banks. Finally, 74% cite that they would share far more personal data in exchange for better banking services.



Demand for value-added service



Percentage of SMEs willing to pay for VAS

SMEs themselves are digitizing as they look to improve how they can engage with customers, bring more efficiency into the business and differentiate against competitors. The focus on digitization accelerated through the COVID-19 pandemic, with more than half of SMEs (~65%) having either maintained or increased the level of digitization of business processes (e.g., taking orders online, online payments, etc.) within the past 12 months.

So what: emerging banks, FinTech and big tech are leveraging nimbler digital-native technology platforms, automated processes, and sophisticated data and analytics capabilities to meet SME banking needs with a lower cost-to-serve, and a significantly better experience. Most digital neo-banks use automated KYC or onboarding to offer functioning transaction accounts to SMEs in 24 hours, while many FinTechs are going even further with 15-minute account opening journeys. Data on transaction flows subsequently enables digital-first banks and FinTechs to better understand actual credit risks, cash flows and short-term financing needs and to offer bespoke financing offers.

Leading banks will transform their data and technology platforms and reimagine fragmented digital processes into front-to-back automated journeys, to retain the primary banking relationship with existing SME customers and to rapidly acquire new ones.

Laggard banks will either lose transaction flows to digital-native challengers and become low-margin product factories or exit the SME market to refocus on the already competitive corporate and commercial banking market.

Contacts

Suruj Dutta

MENA Payments and SME Banking Leader
EY Consulting LLC (Abu Dhabi Branch)
suruj.dutta@ae.ey.com

Sounabh Mandal

Senior Manager, Technology Consulting
EY Consulting LLC
sounabh.mandal@ae.ey.com

Praveen Kumar

Senior Manager, Technology Consulting
EY Consulting LLC
praveen.kumar@ae.ey.com

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